

Message Text

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FOR EB/IFD/ODF: JOHN BLANEY

E.O. 11652: N/A
TAGS: EFIN EAID ORER
SUBJ: SENATOR GRAVEL'S PAPER ON TAXATION FOR DEVELOPMENT
ASSISTANCE

REF STATE 009837

1. EMBASSY APPRECIATES THE DEPARTMENT'S RECOGNITION OF COMPLEX ISSUES IN SENATOR GRAVEL'S PROPOSAL, ISSUES WHICH ARE CERTAINLY BEYOND THE STAFF AND DATA RESOURCES OF THIS MISSION TO EXAMINE. THESE COMPLEXITIES CHIEFLY RELATE TO (1) THE OPERATION OF US TAX LAW WHICH AS IT IMPACTS US MNCS WOULD AFFECT THE EFFICACY OF THE SENATOR'S PROPOSAL, E.G. THE VARYING TREATMENT OF US CORPORATE FOREIGN BRANCHES VERSUS SUBSIDIARIES; AND, (2) THE IMPLICATIONS OF THE PROPOSED UTILIZATION OF VARIOUS INTERNATIONAL FINANCIAL INSTITUTIONS, E.G. MAXIMUM US SHARE; EFFECT ON VOTING RIGHTS, ETC.

2. WE HAVE CONSIDERED THE PROPOSAL INsofar AS THIS EMBASSY'S PAROCHIAL CONCERNS EXTEND, IN ITS GENERAL IMPLICATIONS, SINCE IRAN WOULD NOT QUALIFY AS A RECIPIENT OF US ODA UNDER THE SENATOR'S PROPOSAL.

3. WE ARE NOT ENTIRELY CLEAR ON THE PROPOSED MECHANISM UNLESS (ON PAGE 13 OF THE PAPER "BRIDGING THE GAP--TAXATION. . .") WE ARE TO ASSUME THAT THE PROPOSED TAX ON US FIRMS' FOREIGN TAXABLE
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INCOME IS THE SAME AS THE SUBSEQUENTLY MENTIONED DEVELOPMENT ASSISTANCE TAX. THE 100 PERCENT CREDIT THE US FIRMS WOULD RECEIVE FOR THE NEW DEVELOPMENT ASSISTANCE TAX IS PRESUMABLY AGAINST THE FIRMS'S OR PARENT'S US CORPORATE TAX. THIS WOULD RAISE ISSUES OF CREDIT CARRYOVER, FOR ONE.

4. THE SENATOR'S PAPER AND ANALYSIS REFLECTS WELL, IN OUR VIEW,

THE INCREASINGLY EVIDENT, WIDENING GAP BETWEEN THE DEVELOPED COUNTRIES (DCS) AND THE THIRD WORLD, ESPECIALLY THE LEAST DEVELOPED AND "MOST SERIOUSLY AFFECTED" COUNTRIES. AGREEING WITH HIS RECOGNITION OF "AID FATIGUE," WHICH HAS RESULTED FROM MANY REAL OR PERCEIVED FACTORS, WE CONCUR ALSO WITH THE NEED TO DISCOVER NEW WAYS TO BRIDGE THE WEALTH GAP. WHAT HE BASICALLY PROPOSES IS A PERMANENT, TAX-BASED MECHANISM TO CIRCUMVENT THE "AID FATIGUE" WHICH WOULD SEEMINGLY OBSTRUCT ANY SIGNIFICANT INCREASES IN ODA THROUGHOUT THE NORMAL CONGRESSIONAL AUTHORIZATION PROCESS. THE PROPOSED "DEVELOPMENT ASSISTANCE TAX" ON FOREIGN EARNED INCOME OF U.S. MNCs, WITH ITS 100 PERCENT CREDIT AGAINST, WHAT WE ASSUME TO BE, U.S. CORPORATE TAX, EFFECTIVELY TRANSFERS FUNDS FROM ONE POCKET TO ANOTHER, SUPPORTING FOREIGN ASSISTANCE THROUGH A "FISCAL SUBSIDY." THE RESULT WOULD APPEAR TO OFFER A MOST FEASIBLE MEANS OF ACHIEVING THE DAC TARGET OF FOREIGN ASSISTANCE OF 0.70 PERCENT OF GNP. WITH NO BASIS TO EXAMINE OR QUESTION HIS ASSUMPTION OF THE TAXABLE MNC FOREIGN TAXABLE INCOME LEVELS, WE ACCEPT THAT THE OBJECTIVE CAN BE ACHIEVED. THIS ACCOMPLISHED, IT IS CERTAINLY REASONABLE TO EXPECT THAT THE "BETTER OFF" DCS WILL EMULATE OR IMPROVE A MECHANISM TO PARALLEL THE HIGHER U.S. LEVEL OF ODA. A BASIC APPEAL OF THE PROPOSAL IS THAT IT ASSUMES UTILIZATION OF EXISTING U.S. AND INTERNATIONAL INSTITUTIONS DEALING WITH DEVELOPMENT ASSISTANCE, THUS AVOIDING THE CRITICISM OF FUELING THE PROLIFERATION OF ASSISTANCE INSTITUTIONS. NO COMMENT IS OFFERED ON THE PROPOSED THREE-WAY ALLOCATION DIVISION, BUT THERE IS HERE PERHAPS SOME FLEXIBILITY IN MODALITIES.

5. THE PROPOSED REFUND TO THE FIRM (P. 15 OF PROPOSAL), IN ADDITION TO THE 100 PERCENT TAX CREDIT, WOULD APPEAL MORE TO THE UNCLASSIFIED

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EXTRACTIVE AND MANUFACTURING ENTERPRISES, OF WHICH THERE ARE FEWER EVIDENT IN IRAN THAN IN PAST YEARS DUE TO IRAN'S INVESTMENT AND INDUSTRIAL POLICIES. THE BULK OF TAXABLE INCOME EARNED BY US FIRMS IN IRAN WOULD RELATE TO SERVICE CONTRACTORS AND MANY OF THESE WOULD APPEAR NOT TO HAVE ANY DESIRE TO INVEST IN LDC'S EVEN IF SUCH WERE POSSIBLE. THUS, INsofar AS IRAN IS CONCERNED, LITTLE INCENTIVE WOULD DERIVE FROM THIS EXTRA REBATE.

6. ON THE CAUTIONARY SIDE, WE SUGGEST THAT ONCE THE US LEGISLATIVE HURDLE IS PASSED, THE DISBURSEMENT END OF THE PROPOSAL MAY RUN INTO DIFFICULTIES IN THE ATTACHMENT OF THE PROPOSED HIGH AND COMMENDABLE STANDARDS TO THE RECIPIENT COUNTRIES. COMPARED WITH ACHIEVING MNC ACCEPTANCE OF CODES OF CONDUCT AND ARBITRATION SYSTEMS, WE SEE AS MUCH MORE DIFFICULT THE ACCEPTANCE BY LDC'S AND LDC-INFLUENCED UN AND OTHER INTERNATIONAL BODIES THE RECIPIENT COUNTRY CRITERIA ENVISAGED IN THE PROPOSAL-I.E. COMPLIANCE WITH HUMAN RIGHTS CONVENTIONS AND ACCEDENCE TO NEW INTERNATIONAL CONVENTIONS ON SETTLEMENTS OF DISPUTES, EXPROPRIATIONS, ETC. THERE ARE INDEED FEW LDCS WHICH WOULD MEASURE

UP WITH A STRICT INTERPRETATION OF THE HUMAN RIGHTS NORMS ESPOUSED BY THE US. WE ARE THUS FACED WITH THE NOT NEW PROBLEM OF DECIDING TO ADDRESS HUMAN NEEDS WITH FEW CONDITIONS OUR PUT THEM BEYOND REACH BY HIGH IDEALS. DONALD JOHNSON'S ARTICLE IN THE DECEMBER "FOREIGN SERVICE JOURNAL" IS INSTRUCTIVE ON THIS DILEMMA.

7. ON BALANCE, HOWEVER, THE PROPOSAL MINIMIZES THE TYPE OF NATIONAL INTEREST REQUIREMENTS, SUCH AS TIED-AID AND SHIPPING REQUIREMENTS, AND, BY UTILIZING MAINLY ESTABLISHED INTERNATIONAL INSTITUTIONS SUCH AS THE WORLD BANK GROUP AND THE UNDP, DIFFUSES POLITICAL FACTORS. (IF HIS VIRTUE DOES NOT TURN OUT TO BE ITS NEMESIS INSOFAR AS ITS LEGISLATIVE PROSPECTS ARE CONCERNED.) ADDITIONALLY, THE US FISCAL IMPLICATIONS OF DIVERTING SUCH FUNDS FROM THE TAX INCOME PIE WILL NEED TO BE EXPLAINED WITH ALL THE FORCE OF THE ARGUMENTS CONTAINED IN THE SENATOR'S PAPERS CONCERNING US NATIONAL SELF-INTEREST, MULTIPLIER
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EFFECT, ETC. THE ULTIMATE REQUIREMENT IS THE STILL DIFFICULT PROBLEM OF EFFECTING ECONOMIC AND SOCIAL CHANGE IN THE DEVELOPING COUNTRIES THROUGH RESOURCE AND TECHNOLOGY TRANSFER, ESPECIALLY WHEN THE AGENTS OF CHANGE ARE FOREIGN, AND IN THE CASE OF UNDP, ARE ALREADY LESS THAN CONVINCING IN THEIR ACHIEVEMENT RECORDS. THIS OLD AND BASIC PROBLEM HAS OF COURSE NOT BEEN ADDRESSED BY THE GRAVEL PROPOSAL.
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